Technical Assistance Assuming Greater Role in Business Assistance Programs

Ensuring credit availability in underserved areas or to disadvantaged businesses while minimizing program cost to taxpayers will become more challenging as private lenders use more sophisticated techniques to identify acceptable credit risks in the small business sector. Increasing service—in the form of better monitoring and provision of technical assistance—is seen as the best way to promote financial and program success.

The financial sector is evolving rapidly. The availability of more comprehensive databases combined with more sophisticated analytical tools for identifying acceptable credit risks may reduce the need for Federal business assistance among those small businesses that can be screened through ciphers such as credit scoring. Among these businesses, greater financial integration is expediting the flow of funds to their most productive uses, tapping funds from both traditional financial institutions and nontraditional lenders such as suppliers. Small business borrowers are securing an increasing share of their credit needs from institutions outside the local community. Federal business assistance programs must evolve with the financial sector to ensure that public resources are used to increase the availability of capital to businesses that are otherwise excluded from participation in capital markets. The implication of these developments is that Federal programs will have to continually develop tools to reduce risks, given public policy goals.

Greater emphasis on targeting distressed communities will reduce the likelihood that Federal programs assist businesses that are already well served by private institutions. The challenge of reducing risks while meeting these policy goals is being addressed in two ways. First, the delegation of processing tasks from agency to private partners has freed up Federal resources for better monitoring of lender and borrower performance. Second, technical assistance—which has been integral in many business assistance programs from the outset—is being reinvigorated. For example, both the Small Business Administration (SBA) and the U.S. Department of Agriculture (USDA) teamed up with the Manufacturing Extension Partnership within the National Institute of Standards and Technology to provide small business and farm assistance in responding to the Y2K crisis. A proposed initiative in the 2001 budget involving these same agencies would develop e-commerce capabilities among clients. More generally, the Internet is providing new opportunities for disseminating information to very specialized small business audiences as well as providing interactive services that were unimaginable just a few years ago. The FY 2000 budget appropriation for technical assistance within the SBA was less than actual expenditures in 1999, mainly due to a slight decline in funding for the Small Business Development Centers that comprise the majority of technical assistance expenditures. However, the SBA proposes to significantly increase technical assistance in 2001, largely through new initiatives discussed below.

Some regions, still, are not participating fully in the new prosperity generated by an otherwise robust economy. In response, the New Markets initiative seeks to (1) mobilize underutilized resources in distressed inner cities, rural areas, and Native American reservations to increase national economic growth without fueling inflationary pressures; and (2) lessen regional disparities by targeting job creation in high-poverty areas (see “Recent Changes Advance New Markets and Livability Initiatives” in this issue). Expansion and retargeting of several existing business assistance programs within the SBA and USDA may make a substantial contribution to this initiative, focusing on the development of indigenous businesses by combining financial and technical assistance.

Groups that historically have been disadvantaged in securing credit from formal lenders are the other focus of business assistance programs. Although less visible than the New Markets initiative, both the structuring of loan programs to assist these groups and the targeting of technical assistance programs to these groups have expanded over the past several years. Lending to minority- and women-owned businesses through the SBA section 7(a) Guaranteed Loan program has nearly tripled since 1994. More than 80 Women’s Business Centers affiliated with the SBA now provide startup and managerial assistance to women entrepreneurs and small business owners. In contrast to the Small Business Development Centers (SBDC’s) that provide the majority of technical assistance services within the SBA, the Women's Business Centers are much more likely to be located solely in metropolitan areas within a State. Among many other things, the centers emphasize the promotion of entrepreneurship as an alternative path from welfare to work. Financing for microenterprise startups has been provided by the SBA section 7(m) Microloan program, the Intermediary Relending Program and Rural Business Enterprise Grant program of USDA's Rural Business-Cooperative Service to fund Revolving Loan Funds, and EDA's Economic Adjustment Program.

Guaranteed Loans to Small Business Projected To Increase

The SBA loan guarantee program is the largest single source of Federal financial assistance for small business (table 1). The 7(a) program guarantees loans to small businesses unable to secure financing on reasonable terms from private lenders. The program operates through private lenders that provide loans. Generally, SBA guarantees a maxi-

Table 1

Federal funding for selected business assistance programs by fiscal year[1]

Most business loan guarantee programs are expected to increase their loan activity in 2000

Program	1999 actual	2000 estimate	Change	Rural areas most affected by the program[2]
	Billion dollars		Percent	
SBA 7(a) business loan guarantees	9.47	9.75	3	Service and retirement counties and counties in the West
SBA Certified Development Company guarantee (section 504)	1.98	3.00	52	Service counties and counties in the West
SBA disaster loans	0.76	1.05	38	Places experiencing disasters
RBS Business and Industry loan guarantees (B&I)	1.24	0.90	-27	Government counties and counties in the West
RBS Intermediary Relending Program	0.03	0.04	15[3]	Poverty and transfer counties and counties in the West
RBS Rural Business Enterprise Grants (RBEG)	0.04	0.04	11[3]	Poverty and transfer counties and counties in the South
EDA Economic Adjustment Grants	0.03	0.03	0	Service and commuting counties and counties in the South

Note: SBA = Small Business Administration; RBS = Rural Business-Cooperative Service, U.S. Department of Agriculture; EDA = Economic Development Administration, U.S. Department of Commerce.

[1]Budget authority used for grant programs; projected loan levels (obligations or program level) used for loan programs. In some cases, budget authority may be falling at the same time that projected loan obligations are rising. This can happen for any number of reasons, including making use of greater efficiencies, reducing subsidies, charging fees and using unobligated balances of funds from prior years.

[2]County types are defined in the appendix.

[3]Calculated on actual expenditures and estimated expenditures. Does not correspond to table entries due to rounding.

Source: *Budget of the United States Government, Fiscal Year 2001*.

mum of 80 percent of the principal for loans of $100,000 or less, and 75 percent for loans over $100,000. The maximum guarantee amount is $750,000.

Use of the program increased last year, rebounding from a modest decline in 1998. With the exception of 1998, loan guarantees have increased steadily over the past 5 years. Loan guarantees in 1999 totaled $9.471 billion, and there is budget authority for $9.753 billion in 2000.

One result of the continued strength of the economy has been a substantial reduction in the number of new business starts since 1996. According to data collected by the National Federation of Independent Business, the number of new business starts declined by 32.8 percent from 3,479,000 in 1995 to 2,335,000 in 1998. Given tight labor markets, it is commonly believed that potential entrepreneurs are currently content to remain as employees. The increase in small business loan guarantees amid declines in the number of initial startups is explained by the robust economy, which has led to a decline in the number of small business closings and startups, and an increase in the number of successful small businesses that are seeking loans for expansion.

In 1998, nonmetro areas received $18.53 ($19.45 in 1997) in per capita small business 7(a) guaranteed assistance, versus $25.26 ($27 in 1997) in metro areas. The nonmetro areas that benefited most were in Western States, in retirement-destination counties, and in counties specializing in services.

Activity has also grown in SBA's large section 504 Certified Development Company (CDC) program. A CDC is a nonprofit corporation set up to invest in the economic development of the surrounding community or region. The objective is to provide long-term financing for major fixed assets such as land and buildings. In contrast to the 7(a) program, funds from private lenders provide approximately 50 percent of the loan, from the SBA through debenture sales provide not more than 40 percent of the loan, and from the borrower a minimum 10-percent equity contribution. In 1999, about $2 billion in CDC debenture guarantees were made available, with budget authority for as much as $3 billion in 2000.

Metro areas tended to benefit more from this program than nonmetro areas. In 1997, nonmetro counties on average received $4.57 per capita in 504 debenture guarantees, compared with more than $7 per capita in metro counties.

USDA Business Assistance Programs

The main business programs of the USDA Rural Business-Cooperative Service (RBS) are the Business and Industry (B&I) Guaranteed and Direct Loan program, the Intermediary Relending Program (IRP), and the Rural Business Enterprise Grants program. Unlike other Federal business assistance programs, RBS programs serve rural areas exclusively. Generally, RBS programs are available to unincorporated areas and cities with 50,000 or fewer residents. However, the IRP is limited to unincorporated areas and cities with 25,000 or fewer residents. The objectives of these programs are to create employment and diversify the economic base in rural communities.

The B&I Guaranteed Loan program works with commercial lenders in rural areas. The average guarantee is 80 percent of the loan amount. Historically, the program has enjoyed very low default rates. The estimated program level of $900 million in 2000 is considerably lower than the $1.18 billion provided in 1999. However, this still represents a substantial increase in the support of rural business over the past several years. In 1993, B&I loan guarantees totaled $100 million. In 1998, rural counties received $11.77 per capita in loan guarantees from the B&I program, compared with $18.53 for the SBA section 7(a) program. The maximum outstanding aggregate loan amount to any one business is $25 million.

Unlike the Guaranteed Loan program, the B&I Direct Loan Program assists businesses in targeted areas with loans, which are not otherwise available from a commercial lender, with or without a guarantee. The estimated program level in 2000 remains the same as in

1999 at $50 million. The maximum aggregate outstanding loan amount to any one business is $10 million.

The IRP finances business facilities and community development projects through the establishment of revolving loan funds. An intermediary—i.e., a private nonprofit corporation, public agency, Native American group, or cooperative—borrows funds from RBS at 1 percent interest and then relends to ultimate recipients. The term of the loan to intermediaries can be as long as 30 years. The interest rate is 1 percent per annum. However, the intermediary determines terms of loans to ultimate recipients. The subsidized rate partially covers administrative costs associated with the revolving loans. Despite high program costs relative to loanable funds, the IRP has been aptly suited to implement microenterprise lending programs. Such programs may be more appropriate for supporting entrepreneurship in distressed communities or among former recipients of public assistance. Nonprofit organizations have been a traditional conduit of IRP funds to ultimate recipients, and these organizations have an advantage in developing social collateral among borrowers that is key to microenterprise lending.

RBS may make grants under the Rural Business Enterprise Grant (RBEG) program to public bodies, nonprofit corporations, and federally recognized Indian Tribal groups to finance and facilitate development of small and emerging private business enterprises located in areas outside the boundary of a city of 50,000 or more and its immediately adjacent urbanized or urbanizing area. Costs that may be paid from grant funds include the acquisition and development of land and the construction of buildings, plant, equipment, access streets and roads, parking areas, and utility and service extensions; refinancing; fees for professional services; technical assistance and related training for adults; startup operating costs and working capital, providing financial assistance to a third party; production of television programs to provide information to rural residents; and to create, expand, and operate rural distance learning networks. Grants may also be made to establish or fund revolving loan programs.

A Memorandum of Understanding (MOU) with the Small Business Administration was recently developed that will allow RBS borrowers to obtain needed technical assistance from the Small Business Development Centers. In addition, the MOU provides both Agencies with opportunities to work together to foster job creation and economic development in rural areas.

EDA Economic Adjustment Program

Economic Adjustment grants help local areas respond to changes in the economy that threaten the underlying economic base. Grants can be used for the design or implementation of strategies to adjust to these changes by State or municipal government, CDC's, or other nonprofits recognized by EDA as representing a Redevelopment Area. A principal selection criterion is the extent to which a proposed project will leverage private investment to strengthen the economic base of the area. Implementation activities commonly include the creation or expansion of strategically targeted business development and financing programs, including grants for revolving loan funds, infrastructure improvements, organizational development, and market or industry research and analysis. Funding for the program has been level since 1998 at a little over $30 million.

The highest level of per capita business assistance to rural counties, taking all of the programs in 1998 into account, was in the West (fig. 1). However, between 1997 and 1998, the level of per capita funding in nonmetro counties declined in the West and increased in the Northeast, Midwest, and South. In 1998, 406 nonmetro counties received no assistance, versus 332 such counties in 1997.

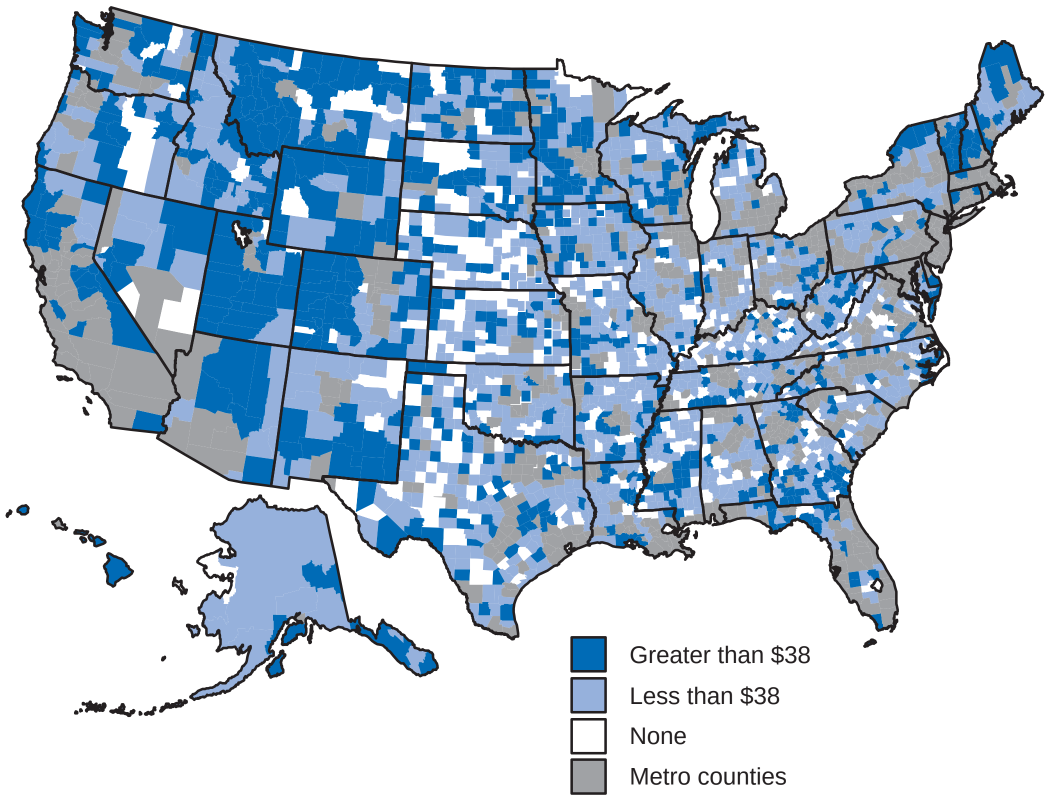
Augmenting Traditional Technical Assistance

The traditional mainstay of business development assistance has been the network of Small Business Development Centers (SBDC's) of the SBA. Close to 90 percent ($89 million) of SBA's business development assistance in 1999 funded the SBDC's. However,

Figure 1

Per capita Federal nonmetro business assistance, fiscal year 1998

Business assistance was greatest in the West



Source: Calculated by ERS using Federals Funds data from the Bureau of the Census.

this expenditure leverages a minimum 50-percent match from the private sector, educational institutions, and State and local government. All told, SBDC services are available in close to 1,000 locations, commonly State universities and community colleges or associated with economic development organizations. Availability of service—counseling, training and technical assistance in all aspects of small business management—has been an important criterion in the location of centers within States. Special programs include international trade assistance, procurement assistance, and venture capital formation, and complement assistance in overcoming financial, marketing, production, engineering or other technical problems. Center staff, paid consultants, and volunteers from the Service Corps of Retired Executives or the local business community tailor services to the needs of individual clients.

SBA is beginning to augment traditional technical assistance by building competence in e-commerce, facilitating collaborative relationships between small businesses and their corporate customers, stressing innovation within the small business sector, and promoting entrepreneurship in distressed areas.

The FY 2001 budget request includes initiatives to fund commercialization assistance for successful Small Business Innovation and Research award projects (SBIR Phase III) and to promote entrepreneurship in distressed areas under the Program for Investment in Micro-Entrepreneurs (PRIME). The SBIR program has addressed the significant underrepresentation of small- and medium-sized business in federally funded research and development efforts. The first stage of the program funds feasibility studies of proposed innovations. Phase II funds development of the most promising Phase I projects. Phase III of the SBIR program will work to bring successful innovations to market.

The request for funding of the PRIME initiative is spurred by the New Markets initiative, to provide technical assistance to recent and aspiring entrepreneurs in distressed areas. The ratio of expenses for technical assistance to loanable funds in microenterprise programs is much higher than for small business generally. Microenterprise loan amounts are typically less than $5,000, with the development of entrepreneurial skills especially crucial to success in business.

Both the BusinessLINC (Learning, Information, Networking, and Collaboration) and the Electronic Commerce initiatives address the perception that 'interconnectivity' between businesses will become more critical to business success. The BusinessLINC initiative received appropriations of $1.5 million in 2000 to stimulate relationships between large businesses and small business owners or entrepreneurs, especially in rural areas and inner cities. These relationships may be technical assistance, counseling, or consulting, with anticipated outcomes including strategic alliances and better supplier relationships. The proposed Electronic Commerce initiative would improve education and training of small businesses in this rapidly developing area and thereby increase their ability to retain and grow the customer base as both retail and business-to-business sales shift to the Internet.

The value of the Internet to small business is also demonstrated by the development of several SBA web sites to disseminate technical information to specialized small business audiences. *TradeNet's Export Advisor* (http://www.tradenet.gov), developed by SBA with substantial interagency collaboration, serves as one-stop access to government advice for businesses selling products overseas. The site provides tutorials on how to begin exporting along with information on trade leads. The PRO-Net Procurement Marketing and Access Network (http://pro-net.sba.gov) is an electronic gateway for procurement information allowing small businesses to market their capabilities to government agencies and other contractors seeking small business subcontractors. The network also allows small business to identify procurement opportunities. The Small Business Classroom (http://classroom.sba.gov) provides online courses in a wide variety of management subjects, counseling by SCORE volunteers, and contacts to SBA training and conferences when virtual contact proves inadequate.

The traditional one-to-one technical assistance model developed in the SBDC's is being extended and augmented. The BusinessLINC initiative would include large businesses as viable mentors. The PRIME program extends one-to-one entrepreneurial assistance to disadvantaged individuals in distressed communities. The Internet can disseminate specialized information and link small businesses and their potential customers, as demonstrated in the PRO-Net program. Finally, the ability of innovative tools to solve common small business problems was demonstrated by the successful rollout of the Y2K Toolkit, providing a model for the proposed Electronic Commerce Toolkit. The ability of these technical services to assist small business is likely to become more critical to the success of Federal loan guarantee programs as private lenders become more willing to fund the better small business risks. *[Tim Wojan, 202-694-5345, twojan@ers.usda.gov]*